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**DIRECTORATE OF
INTELLIGENCE**

Intelligence Memorandum

The Economic Situation in South Vietnam

USAID review completed

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CENTRAL INTELLIGENCE AGENCY
Directorate of Intelligence
September 1972

INTELLIGENCE MEMORANDUM

THE ECONOMIC SITUATION IN SOUTH VIETNAM

Summary

1. The limited recovery of business activity in Saigon underway since mid-June has stalled. Consumer demand reportedly has fallen off, imports remain below normal, and business is sluggish. The slack in consumer demand is reflected in the retail price index which, after nearly two months of steady increases, has been relatively stable over the past month. The near-term outlook for further recovery is not particularly bright because of the low level of investment and import licensing. However, upward pressure on prices will continue, bolstered by the recent 15% government pay raise.
2. The government is making tentative moves to cope with the difficult combination of renewed business downturn and growing government deficit. These moves include limited manipulation of interest rates to encourage commercial bank lending to the private sector, new taxes (probably to be implemented in October), and increased efforts to cut expenditures. However, the key to recovery is consumer confidence and demand, and these depend primarily on the military situation. It is likely that only a continued reduction in hostilities can bring the economic stability and growth the government is seeking.
3. The rice situation continues to plague the economy. The price of rice still is rising about 1% a week, despite increased sales from imported stocks. In addition, poor weather and increased military activity in the Delta suggest a poor outlook for the next harvest. Rice imports in 1973 probably will rise somewhat above the 1972 level of some 300,000 metric tons and could go much higher.

Note: This memorandum was prepared by the Office of Economic Research.

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4. The adverse effects of US troop withdrawal - principally unemployment and losses in foreign exchange earnings - were blunted in 1971 and early 1972 by the continuation through June 1972 of large US military construction programs and sharply increased personal expenditures. In addition, the economic consequences of the present offensive and recession have overshadowed and tended to obscure the impact of the US withdrawal. A complete evaluation of the cumulative effects of the US withdrawal will be possible only when the offensive slows down and the economy returns to some semblance of normality.

5. One encouraging development during the offensive has been the growth of the financial system. This is reflected by continued increases both in time and savings deposits and in the number of banks operating outside Saigon. If the military situation improves, these banks should be able to provide a growing share of the agricultural credit needs of the country, now virtually ignored by the Saigon commercial banking system.

6. Charts on foreign exchange reserves, money supply and prices, gold and currency prices, and the government budget (Figures 1-5) follow the text.

Current Developments

Business Recession Continues

7. After some signs of a limited recovery, economic activity in Saigon has slowed again in recent weeks as consumers and businessmen react to the ups and downs of the war. US officials report that demand has again fallen off and, with the consequent accumulation of inventories of finished goods, some sectors of manufacturing appear to have begun another decline. Further compounding the economic malaise, middlemen and wholesalers reportedly are reluctant to transport or store goods, presumably because of the military situation. Despite the slowdown, however, unemployment apparently is not yet a serious problem. Employment cutbacks, while relatively extensive in some areas, have not kept pace with the overall business decline because firms have chosen to carry employees for routine maintenance work and at reduced hours or wage rates. As another plus, the slackening of demand for commodities has eased the pressure on prices. Saigon retail prices, which rose steadily during July and the first half of August (8% in seven weeks), have been relatively stable for the past month. However, food prices, particularly for rice, continue to move upward. Retail prices are now up 11% from the start of the offensive and 17% for the year.

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8. The outlook for renewed recovery is not particularly bright at the moment. The now-blunted quickening of business that began in June was primarily due to a pickup in demand as consumers restocked necessities. Apparently, they now are again choosing to hold a maximum of earnings in cash or near-cash as insurance against sudden changes in the war or economic policy. Consumer demand could revive - and again falter - at any time. Business investment, however, has come to a virtual halt, and it may be some time before a recovery to the production levels of early 1972 can be achieved. Sales of investment-related goods such as iron and steel and cement are less than half pre-offensive levels, and import licensing of these items also is at an extremely low level. In addition, outstanding commercial bank credit has declined from the June level, at first reflecting repayment of overdue loans as business conditions improved, but now apparently due to a low level of new loans. Time and savings deposits continue to grow rapidly, but commercial banks, reluctant to risk their funds in credit to the private sector because of the uncertainty of the military situation, have been putting their increasing reserves into government bonds.

New Government Measures

9. On 18 September the government lowered interest rates on bonds that have been siphoning commercial bank funds away from the business community. These bonds - which carried an interest rate of 22% before the recent decision to lower them to 18% - had become a major hedge for the banks. To neutralize the effects of this move on bank profits, the government will increase the interest paid on bonds that banks must hold as part of their reserves. Through these measures, the government hopes to restimulate the flow of funds from the rapidly growing time and savings deposits to private-sector enterprises.

10. The government has approved the first basic pay raise in two years for the approximately 1.5 million South Vietnamese in the military and civil service. A 15 September decree, retroactive to 1 September, calls for 50%-60% boosts in base pay; but, since low-ranking servicemen and civil servants receive most of their income from family and other special allowances, the average overall increase will amount to about 15%. The increase, therefore, is less than the rate of inflation thus far this year. The added cost to the government through the remainder of this year will be about 10.4 billion piasters, or \$24 million. Although a rather commendable attempt to maintain the real incomes of its employees, the government's pay increase will certainly add to price pressures.

11. In an effort to reduce the growing spread between its own revenues and expenditures, the government has decided to decree new

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income, excise, and motor vehicle taxes. The decree will probably come in early October. It had previously been planned to enact an entire package of revised and new taxes, but it became clear that the formulation of such a complicated package would take too long and would put off implementation until well into 1973. Efforts also will be made either to cut some central government expenditures entirely or to transfer the burden to local governments. However, increasing requirements for direct military expenditures, combined with refugee relief, reconstruction, and increased government salaries resulting from the pay raise, will make this task almost an impossibility.

Foreign Exchange Markets

12. There have been no new developments in official exchange rates or regulations since 22 August (the most recent devaluation), and black market gold and currency prices have remained relatively stable. The price of dollars on the Saigon black market (presently 426 piasters to the dollar) remains below the official piaster/dollar exchange rate of 435:1. This apparently is the result of the continuing shortage of cash and the conversion of private dollar holdings into piasters. The gold market has been very quiet, with gold prices remaining stable over the past three weeks. On 18 September, gold was selling at about 26,700 piasters per troy ounce, or \$61 converted at 435:1.

Continued Rice Problems

13. Early, optimistic predictions of rice self-sufficiency in 1972 melted with the offensive, and imports this year probably will amount to about 300,000 tons - more than double the 1971 level. These imports became necessary in part as a result of direct losses and destruction, as well as planting and transport uncertainties. It also appears, however, that initial production estimates for the 1971/72 crop year (ending 31 May 1972) were overstated by 50,000 to 100,000 tons.

14. The price of rice, which has climbed steadily since late June, continues to move up about 1% a week, despite increased sales of imported rice. New arrivals of rice from the Delta have slowed markedly in recent weeks as paddy reserves from last year's harvest dwindle, and there is little prospect for any substantial upswing in the volume of new rice arrivals from the Delta before the major harvest at year's end. The government already is drawing on its reserves of imported PL-480 rice, with additional imports scheduled to arrive through the rest of this year.

15. Estimates for the 1972/73 crop are increasingly pessimistic in light of the continued high level of enemy activity in major rice-growing regions.

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Of even more immediate importance, however, is the weather, which will probably be the decisive factor in determining the quantity of this year's crop. Inadequate rainfall following late planting is having a serious impact on the production outlook, and current predictions range between no increase and a decline in 1972/73 production. In any event, South Vietnam will have to continue importing a substantial amount of rice through 1973. US observers now estimate that 1973 rice import requirements will be at least another 300,000 tons, and - under further adverse conditions - this figure could double. Meeting South Vietnam's projected 1973 rice deficit may also be complicated by the present dearth of rainfall throughout Southeast Asia. Increasingly gloomy predictions of next year's crop are coming from many of the rice surplus countries, and there could be considerable pressure on the world market and PL-480 stocks.

Effects of US Withdrawal

16. US troop reductions, which began in early 1969, were originally expected to pose serious and fairly immediate problems for the economy because of heavy South Vietnamese dependence on US piaster purchases for foreign exchange and on US service requirements for local employment. Further indirect consequences were expected from the shrinkage of Vietnamese industries and services catering to those employed in the US sector. In 1971 and early 1972, however, the potentially disruptive consequences of the US withdrawal were blunted somewhat by the continuation of large US military construction programs (which ended in June 1972) and sharply increased personal expenditures resulting from the adoption of more realistic exchange rates.

17. More recently, the impact of continued US layoffs and reductions in piaster purchases has been in part offset or camouflaged by the enemy offensive. Consumer and investment demand fell to a low level after the offensive began at the end of March, and the resulting business recession has not ended. Consequently, manufacturers' and importers' requirements for imported raw materials and finished goods remain at a relatively low level. The loss of foreign exchange earnings from US purchases thus has fortuitously been partly offset by the reduction in foreign exchange requirements for imports. At the same time, the impact of US layoffs of locally hired people has been obscured by the rising unemployment resulting from the current business recession and the large number of refugees. Increased manpower requirements of the armed forces probably have also absorbed some of the unemployed males.

18. Looking beyond the offensive, it is hoped that the loss of dollar earnings from US purchases will be offset by such new US economic aid vehicles as the Economic Support Fund (ESF) and the Economic

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Development Fund (EDF). The ESF, for which \$50 million has been requested from Congress for US fiscal year 1973, will be a grant for unrestricted purchase of goods and services. The EDF (\$75 million requested) will be used by Vietnamese credit institutions for infrastructure development projects. Another hoped-for offset to the decline in piaster purchases will be increased local procurement of goods by the US military forces remaining in Vietnam. The employment outlook for those laid off by the United States depends more immediately on the economic situation. In the short run, several factors may ease the potential political and welfare problems. For example, workers probably have accumulated substantial savings knowing that, once the US withdrawal began, their jobs would eventually be eliminated. Severance pay also has provided some cushion. For the longer term, prospects hinge on how quickly and to what extent the economy recovers from the present recession. In any case, however, the observed impact of US layoffs on unemployment rates will not be as great as the former numbers of locally hired people would indicate. The reason is that more than half of the jobs created by the US presence have been held by women, many of whom have simply dropped out of the labor force.

The Financial System Continues Its Expansion

19. One of the few bright spots in the economy throughout the offensive has been the continued increase in time and savings deposits held by commercial banks, private rural banks, and in the provincial branches of the Agricultural Development Bank (ADB). The September 1970 interest rate reform, which approximately doubled the rates paid by commercial banks and led to similar deposit rates at the rural banks and the ADB, initiated a phenomenal increase in financial savings held in commercial banks. These savings increased by 50% in the last quarter of 1970 and doubled in 1971. Totaling 63.4 billion piasters in commercial banks at the end of March 1972, these deposits have continued to rise through most of the offensive, reaching 85 billion piasters on 19 August. Although the increase is due in part to consumer caution, the fact that these funds are now held in banks rather than mattresses indicates growing confidence in Vietnam's banking system. These funds also may play an important role in reconstruction and business financing when more normal economic conditions prevail.

20. Another relatively new development in Vietnam's financial system is the growing network of banking facilities outside Saigon. One of the most encouraging aspects of this growth is the private rural banking system, inaugurated in late 1969. This system consists of small banks located throughout the country and organized by local citizens on broad guidelines provided by the government. Although half the initial capital is subscribed

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by the government, it has no voting rights in these banks' operations. At the end of June 1972 there were 28 such banks, with total deposits of about 500 million piasters. In addition, the ADB maintains a branch bank in each of the 44 provinces. Also, a growing number of commercial banks are located outside Saigon. For example, two commercial banks recently opened in Quang Ngai City in MR 1.

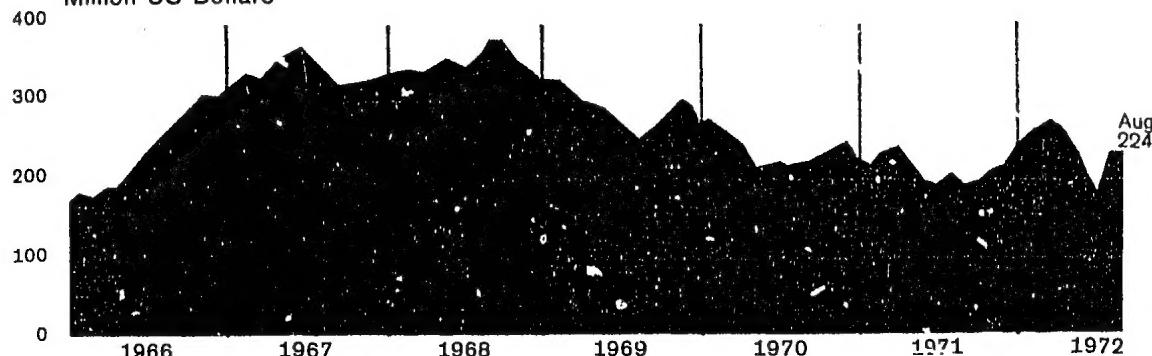
21. At present, less than 1% of commercial bank loans go to agriculture. Given the leading role agriculture is expected to play in future economic growth, the expansion of the financial system into rural areas is a prerequisite for development. The ADB and private rural banks now provide an estimated 12% of agricultural credit needs, the remainder coming from private money lenders, informal credit unions, relatives, or friends. Although this percentage is still small, it is double that prevailing a few years ago. The possibilities for further improvements in rural savings and credit institutions must, of course, be viewed in the context of the still uncertain security situation. Nevertheless, some gains have been registered even during the offensive, and an end to hostilities could bring a rapid expansion of Vietnam's embryonic financial system.

SOUTH VIETNAM

Figure 1

Foreign Exchange Reserves*

Million US Dollars



*Excluding holdings of commercial banks

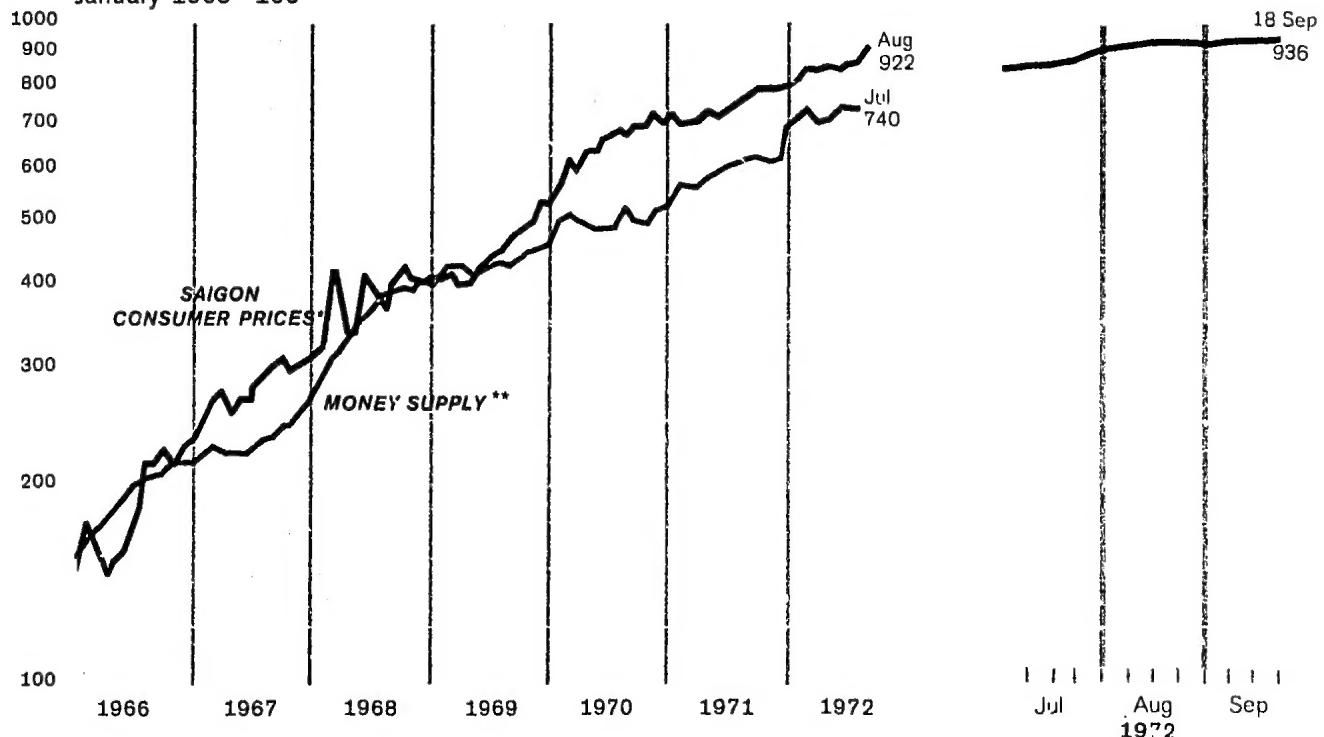
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Figure 2

Indexes of Money Supply and Saigon Consumer Prices

January 1965 = 100



*USAID monthly average retail price index for Saigon

**Data are for end of month

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SAIGON

Free Market Currency Prices

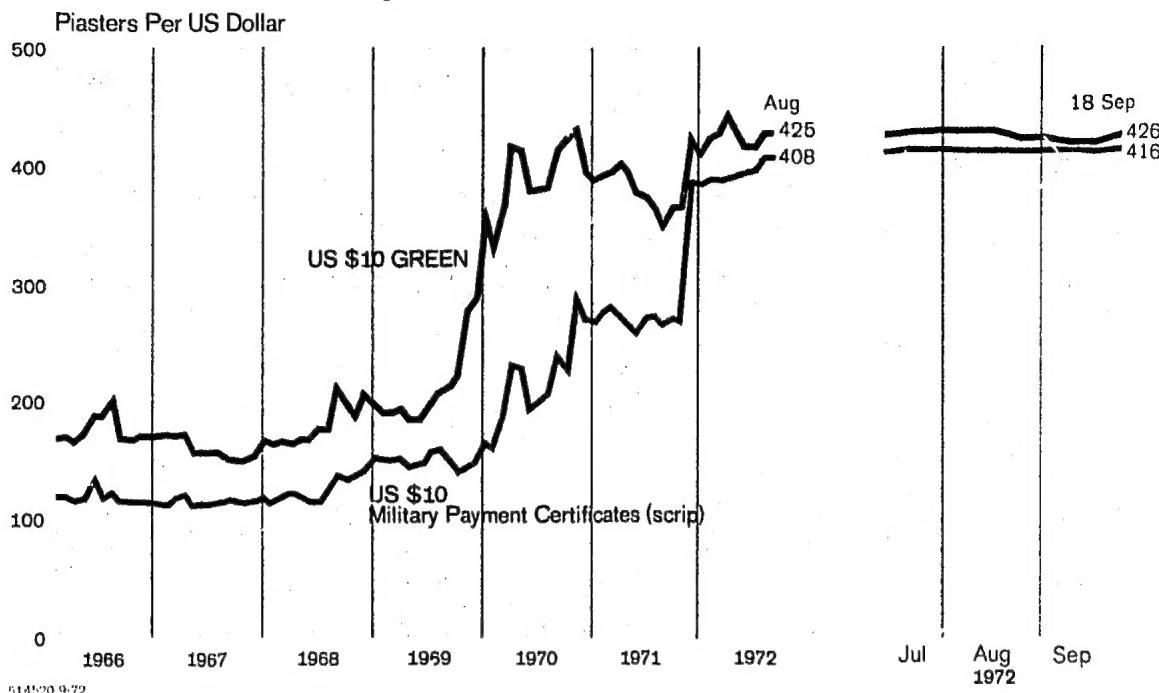


Figure 3

SAIGON

Free Market Gold Prices

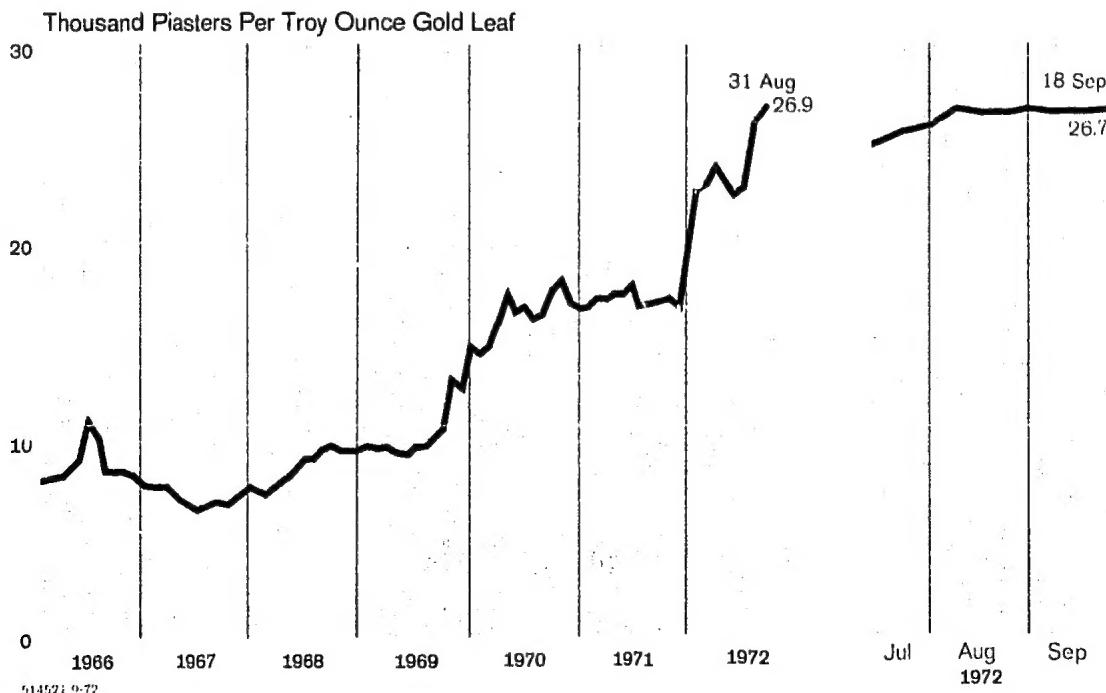


Figure 4

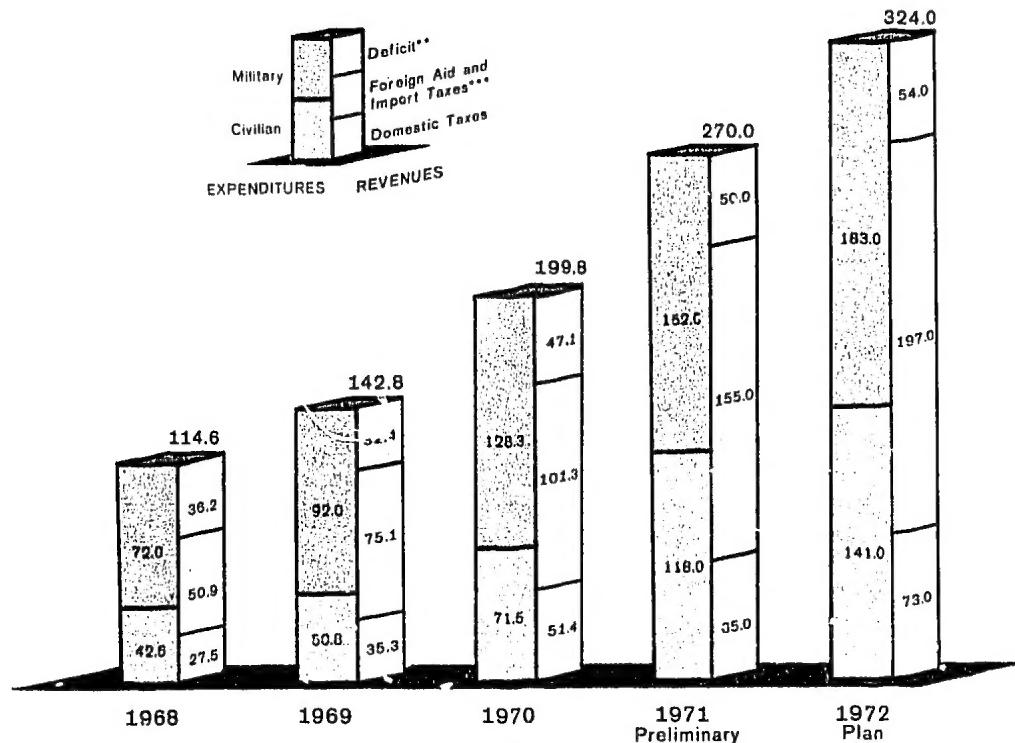
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SOUTH VIETNAM Government Budget*

Billion Piasters

Figure 5



*Data include extrabudgetary revenues and expenditures.

**Residual. Financed primarily by borrowing from the National Bank.

*** Includes customs duties and other import taxes, counterpart funds generated by US-financed import programs, and profits from foreign exchange transactions. A major result of the November 1971 reforms was to make explicit a greater share of US aid to the budget that earlier took the form of high customs duties on aid-financed imports.

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